



Memorandum

TO: HONORABLE MAYOR AND
CITY COUNCIL

FROM: Board of Administration for
the Police & Fire Dept.
Retirement Plan

SUBJECT: Ordinance to Authorize Real Estate
Investment in 501(c)(2) Corporations

DATE: 10-31-05

REASON FOR ADDENDUM

In order to have the San Jose Municipal Code amended to allow a formation of a 501(c)(2) title holding corporation prior to the anticipated acquisition of a new real estate property scheduled to close before the end of the calendar year.

RECOMMENDATION

Approval of ordinance amending Section 3.36.550 of the Municipal Code to authorize the Board of Administration for the Police and Fire Department Retirement Plan to make real estate investments through a title holding corporation described in Internal Revenue Code Section 501(c)(2).

BACKGROUND

Currently, Section 3.36.550 of the Municipal Code authorizes the Police and Fire Department Retirement Plan ("Plan") to investment in real estate in the following forms:

- In its own name or in common ownership with the Federated City Employees Retirement System
- Through a title holding corporation or trust satisfying the requirements of Internal Revenue Code Section 501(c)(25)

Authorization of investment by way of a 501(c)(25) title-holding corporation was added to the Municipal Code in 1999. The main purpose for the title-holding corporation is to limit the exposure of the Plan's assets to only the assets held by the corporation.

ANALYSIS

The Board of Administration for the Police and Fire Department Retirement Plan is in the process of acquiring an interest in two office buildings located in Anchorage, AK, collectively called the Calais Office Center, through limited liability companies ("LLCs"). The Board's real estate attorney (Nossaman, Guthner, Knox & Elliott, LLP) recommends an ownership structure in which the Plan sets up a title holding company in accordance with Internal Revenue Code ("IRC") Section 501(c)(2) and then that title holding company invests in the LLCs and will own 75% interest in the properties with a for-profit entity owning the other 25%. This will provide full corporate insulation to the rest of the Plan against any liabilities that might be incurred by the LLCs. The LLCs themselves will provide full limited liability insulation against any liabilities that might be incurred in the operation of the buildings.

IRC section 501(c)(2) allows the Plan to invest in an LLC (an indirect interest) and maintain tax-exempt status for the investment, while IRC section 501(c)(25) only allows for direct interest in real estate property to remain tax-exempt. The members of the Board's Real Estate Committee and the Board Secretary will act as the Board of Directors of the title holding corporations and operate those corporations the same as the other title holding corporations currently in existence.

IRC 501(c)(2) corporations provide an additional method for making real estate investments. It is the Board's real estate counsel's recommendation that the Plan have the flexibility to use tax exemptions offered by both IRC sections 501(c)(2) and 501(c)(25), depending on the circumstances.

PUBLIC OUTREACH

Not applicable.

OUTCOME

The approval of this recommendation will enable the Police and Fire Board to make real estate investments through a 501(c)(2) corporation, thus providing opportunities for greater diversification of the real estate portfolio.

COORDINATION

The proposed ordinance was prepared by the Office of the City Attorney.

COST IMPLICATIONS

The expenses will be paid from the Police and Fire Retirement Fund. In accordance with the Mayor's Budget Strategy, this proposal meets the following General Principle:

- Continue to emphasize prevention and expenditures that reduce costs to the City and our community.

CEQA

Not a Project.

A handwritten signature in black ink, appearing to read "Edward F. Overton", is written over a horizontal line.

EDWARD F. OVERTON
Secretary, Board of Administration

ORDINANCE NO. _____

AN ORDINANCE OF THE CITY OF SAN JOSÉ AMENDING SECTION 3.36.550 OF CHAPTER 3.36 OF TITLE 3 OF THE SAN JOSE MUNICIPAL CODE TO AUTHORIZE 501(c)(2) TITLE HOLDING CORPORATIONS AS A VEHICLE IN WHICH THE BOARD OF ADMINISTRATION FOR THE POLICE AND FIRE DEPARTMENT RETIREMENT PLAN MAY INVEST IN AND TAKE TITLE TO REAL ESTATE INVESTMENTS

WHEREAS, the Board of Administration for the Police and Fire Department Retirement Plan (the "Board") has exclusive authority for the investment of the assets of the Police and Fire Department Retirement Plan (the "Plan"); and

WHEREAS, pursuant to San José Municipal Code Section 3.36.550, the Board invests a portion of the assets of the Plan in real estate investments of the types listed in Section 3.36.550; and

WHEREAS, Internal Revenue Code Section 501(c)(2) provides federal tax exempt status to certain title holding corporations; and

WHEREAS, the inclusion of 501(c)(2) corporations as a vehicle in which the Board may make real estate investments will provide greater opportunities for diversification of the real estate portfolio; and

WHEREAS, the Board of Administration for the Plan has recommended that Section 3.36.550 be amended to include investments in 501(c)(2) corporations;

NOW, THEREFORE, BE IT ORDAINED BY THE COUNCIL OF THE CITY OF SAN JOSÉ:

Section 3.36.1200 of Chapter 3.36 of Title 3 of the San José Municipal Code is amended to read as follows:

3.36.550 Investments - Real Estate.

A. The Board may:

1. Acquire, hold for investment or sell commercial, industrial and residential real estate, and real estate related debt instruments in the following forms:
 - a. _____ in its own name; ~~or~~

- b. lin common ownership with the federated city employees retirement system;~~;-or~~
 - c. Tthrough a title holding corporation or trust satisfying the requirements of Internal Revenue Code Section 501(c)(25); or
 - d. Through a title holding corporation satisfying the requirements of Internal Revenue Code Section 501(c)(2);
 - 2. Lease real property owned by the Board for any lawful purpose and for terms which may extend beyond the duration of this Retirement Plan;
 - 3. Create restrictions and easements affecting the real property owned by the Board; and
 - 4. Exercise all other rights, privileges and powers which an owner of real property would have, unless otherwise prohibited by the terms of this Retirement Plan or by other applicable law.
- B. The Board shall take title as follows:
 - 1. Title to all commercial, industrial and residential real estate and all real estate related debt instruments acquired by the Board on behalf of this Retirement Plan shall be taken and held in one of the following forms:
 - a. Ddirectly by the Board of Administration in the name of Board of Administration as Trustee for the Police and Fire Department Retirement Fund;~~;-or~~
 - b. Tthrough a title holding corporation or trust satisfying the requirements of Internal Revenue Code Section 501(c)(25); or
 - c. Through a title holding corporation satisfying the requirements of Internal Revenue Code Section 501(c)(2).
 - 2. Title to all commercial, industrial and residential real estate and all real estate related debt instruments acquired by the Board on behalf of this Retirement Plan to be held in common ownership with the Federated City Employees Retirement System shall be taken and held in the following name: Board of Administration as Trustee for the Federated City Employees Retirement Fund, as to an undivided fifty percent interest, and

the Board of Administration, as trustee for the Police and Fire Department Retirement Fund, as to an undivided fifty percent interest, together as tenants in common.

- C. For the purposes of this Section 3.36.550, a title holding corporation or trust satisfying the requirements of Internal Revenue Code Section 501(c)(25) or a title holding corporation satisfying the requirements of Internal Revenue Code Section 501(c)(2) may be such a corporation or trust established by the Board.

PASSED FOR PUBLICATION OF TITLE this ____ day of _____, 2005, by the following vote:

AYES:

NOES:

ABSENT:

DISQUALIFIED:

RON GONZALES
Mayor

ATTEST:

LEE PRICE, CMC
City Clerk